In the Supreme Court of the United States

OCTOBER TERM, 1950

No. 262

CHARLES A. CAROLIN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 111-124) are not officially reported. The *per curiam* opinion of the Court of Appeals (R. 131) is reported at 181 F. 2d 186.

JURISDICTION

The judgment of the Court of Appeals was entered on April 19, 1950 (R. 131), and a petition for rehearing was denied on June 1, 1950 (R. 136). The petition for a writ of certiorari was filed on August 23, 1950. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether the Court of Appeals erred in failing to remand the case to the Tax Court in order that the latter should reconsider in the light of the *Culbertson* decision its finding on the entire record that no real partnership existed between taxpayer and his wife during the tax years in question.

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
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> (a) [as amended by Section 1 of the Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
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> (26 U. S. C. 1946 ed., Sec. 22.)

STATEMENT

The material facts as found by the Tax Court (R. 111-119) are as follows:

The taxpayer's father, Robert E. Carolin, began

a small iron foundry in Detroit about 1912. During the first World War his business increased in size, and at times he employed as many as twenty men. After 1918, however, it began to decline. For lack of orders and modern equipment it was very unproductive by 1933, and Carolin was in financial straits. By 1937 he had only one employee and his shop was in serious need of repair. To provide $50 a week for the maintenance of himself, wife and family, he had allowed taxes to fall in arrears and had borrowed money, using his home and insurance policies as collateral. He died suddenly on November 20, 1937, leaving his widow and nine children surviving. The taxpayer then 22, was next to the youngest. Robert B. Carolin left assets valued at about $23,000, of which about $12,000 was attributed to the foundry. He owed about $3,500 in debts and taxes. (R. 111-112.)

The taxpayer was then living at his parents' home and was employed as a soap salesman. His fiancee was working as a stenographer at a salary of $1,250 a year. His mother, much worried about financial matters and wishing to continue her husband's business, urged him to give up his job and work at the foundry. The taxpayer and his fiancee agreed to postpone marriage in order to comply with his mother's request, and he started work at the foundry for $30 a week shortly afterwards. As the widow inherited one-third of her deceased husband's estate and each of the nine children two twenty-sevenths, the taxpayer ob-

tained a promise from her that she would get all the children to assign their interests in the foundry to her. His fiancee had insisted on this arrangement, promising to keep her job and to help the taxpayer with the foundry work if the business was protected against future claims of his brothers and sisters. With his fiancee's approval he later declined a favorable offer of employment to continue his work at the foundry. (R. 112.)

The mother's settlement with the children was beset with difficulties, but on November 12, 1938, or a few weeks after entry of an order of the probate court fixing the heirs' shares, eight of the children gave her a quit-claim deed of their interests in the foundry. The ninth child did likewise on August 21, 1941. The taxpayer received nothing as consideration for the quit-claim deed he gave, but three of his brothers demanded and obtained notes. A bill of sale covering the personalty was also executed, and on December 9, 1938, the widow filed with the clerk of Wayne County, Michigan, a certificate of conducting business under the assumed name of R. B. Carolin Foundry. Prior to this time, on September 17, 1938, the taxpayer and his fiancee were married and thereafter resided at his mother's home, where the three often discussed business matters and reached decisions. Among these was a major decision to accept a contract for certain work from Clayton & Lambert Company in January, 1939. This contract proved to be very profitable, but in the condition of the business at

the time considerable risk was involved. (R. 112-113.)

To revive the enterprise, the taxpayer devoted long hours to work, and used his own car for business purposes without receiving extra payment therefor. His wife helped him in clerical matters at the shop on Saturdays and Sundays and sometimes handled correspondence at home on evenings of other days. Although some progress was being made, the need for repairs entailed so much expense that no surplus funds accumulated, and he and his wife were discouraged by the prospects. At his wife's urging he requested of his mother some recognition of a proprietary interest if he was to continue, and on July 29, 1939, his mother and he signed an agreement to conduct the business as partners under the name of R. B. Carolin Foundry. They recited in the agreement that the mother had contributed her interest in machinery, equipment and good will as capital and that the taxpayer had contributed his interest in the same property and was to contribute further his skill and experience. They agreed that each share equally in profits and losses; that the taxpayer devote his undivided time and attention as manager and receive compensation therefor; that the partnership assume all debts and liabilities of the business; that the real estate constituting its premises remain the property of the mother and be rented to the partnership, and that the partnership be continued (unless previously dissolved by mutual consent) after the death of

either partner, each agreeing to bequeath to the other one-ninth of his interest and reserving the right to dispose of the rest by will. The last provision was intended to insure control of the survivor. A certificate that the taxpayer and his mother were conducting the business as partners was promptly filed with the county clerk. The taxpayer continued to manage the enterprise as before and his wife, who kept her stenographic position until early in 1941, rendered assistance as before until late in 1940. In lieu of paying rent for the premises to the mother, the partnership paid taxes on them, including arrears. (R. 113-114.)

Early in 1941 the partnership, after expanding its activities, employed an accountant who, in discussing problems with the taxpayer, suggested incorporation as a better means of protecting the taxpayer against possible difficulties with his brothers and sisters after his mother's death. The mother was agreeable; the partnership was formally dissolved, and on October 1, 1941, the R. B. Carolin Foundry & Machine Company was organized as a Michigan corporation with a paid-in capital of $10,000, represented by 10,000 $1 par value shares, of which the taxpayer subscribed for 5,000 and his mother for 5,000. They and a third person were named directors. The partnership's assets (except cash) and liabilities were taken over by the corporation, which immediately issued a certificate for 4,500 shares to "Charles A. Carolin and Helen Carolin"; a certificate for a like number to

the taxpayer's mother, and a certificate for 1,000 shares to "Charles A. Carolin and Louise W. Carolin, Joint Owners with right of survivorship." The taxpayer became president and treasurer, and his mother secretary, with a salary of $200 a month. On October 1, 1941, the mother leased the business premises to the corporation for $200 a month or two percent of gross sales, whichever was greater. (R. 114-115.)

By this time the foundry had fifty employees, the manufacture of screw machine products was begun, contracts for airplane wing sections had been obtained from the Chrysler Corporation, and numerous used machines were being bought, rebuilt, and added to the plant's equipment. Business increased enormously with orders for military requirements, and on its income tax return for the first fiscal year ended September 30, 1942, the corporation reported gross sales of $387,996.10, gross profits of $149,321.20, and a net income of $74,081.84. There were no distributions to stockholders, but $24,808.71 was paid to the taxpayer as salary; $200 a month to his mother as salary and $6,808.71 as rent. An RFC loan of $140,000 was procured and repaid. Before the end of 1942 renegotiation of the war contracts started, and deduction of the amounts paid to the mother were challenged in the computation of profits and were ultimately disallowed. (R. 115.)

After consulting an attorney who specialized in tax matters, the taxpayer and his mother, as stock-

holders representing all outstanding shares, resolved on March 11, 1943, that (R. 115):

> (I) The Corporation sell to a co-partnership to be formed by Mr. Charles A. Carolin, Mrs. Louise W. Carolin and Mrs. Helen E. Carolin, all of the unfilled contracts and purchase orders on hand, all the inventory of raw material and work in process, both in the foundry and in the machine shop and all of the cash in the National Bank of Detroit in an amount of approximately $10,000.00 and all sums due from employees.

The recited consideration was $3,000 payable by the partners, the proposed partnership note for $14,500 and its assumption of listed corporate obligations. On July 1, 1943, "but as of April 1, 1943", the taxpayer, his mother and his wife signed articles of co-partnership to conduct a machine shop and foundry business under the name of R. B. Carolin Foundry & Machine Company. Contribution of 50 percent of the capital by the taxpayer, 25 percent by his wife and 25 percent by his mother was recited, and the profits were to be distributed 40 percent to the taxpayer, 40 percent to his mother and 20 percent to his wife. Each of the three agreed "to devote so much of his time, skill and energy necessary to the best interests" of the partnership; correct records were to be kept, and partnership funds were to be deposited in a bank account subject to withdrawal by one of the partners or by an authorized agent. A certificate of

copartnership was signed and filed by the three on June 21, 1943, with the county clerk. The corporation, however, was not dissolved, but its name was changed to The Carolin Manufacturing Corporation. It retained the lease from the mother on the business premises, and immediately subleased them to the partnership for $1,000 a month; it also retained machinery and equipment which it leased to the partnership, and it held the partnership's $14,500 note. (R. 115-116.)

By bill of sale dated July 1, 1943, "but as of April 1, 1943," the corporation transferred to the new partnership all assets described in the stockholders' resolution, and the partnership gave to the corporation its demand note for $14,500, dated March 31, 1943. Entries as of the latter date were made on the corporate books to reflect a transfer of assets, having a book value of $42,078.37, comprising raw materials, work in process, cash of $10,930.75, and contracts for $290,662.80 of work, entered as an asset at $14,531.14. By entries of the same date liabilities aggregating $24,907.47 were eliminated, comprising $12,869.80 due the taxpayer for salary. The opening entries on the partnership's books indicated assets of $42,078.37, transferred by the corporation, and a note receivable of $1,335.45 due from the taxpayer's wife, or a total of $43,413.82. The listed liabilities of like amount comprised "invested capital" of $2,670.90, representing a transferred note due the corpora-

tion from the taxpayer's mother, $1,335.45, representing a note in that amount given the partnership by the taxpayer's wife, and $1,335.45, representing a part of the salary due the taxpayer by the corporation. The remainder due him, or $11,534.35 appeared also as a liability of the partnership. The taxpayer's wife paid her note by a check drawn against a joint bank account in the names of the taxpayer and herself. (R. 116-117.)

Early in 1941 the taxpayer purchased a residence in the joint names of himself and wife for $9,400, and they ceased to live with his mother. His wife continued to discuss business affairs with him at home; their personal relations were close, and he was appreciative of her encouragement and assistance in clerical work at the foundry from 1938 to the latter part of 1940. From her own savings she had given him $260 for house furnishings prior to their marriage; she contributed $350 in July, 1939, to the purchase of an automobile used largely in the business, and $400 for a second car purchased in September, 1941. Title to both cars were taken in their joint names. She also used over $1,500 of her separate funds for living expenses after marriage and she paid medical bills of $225. After the birth of their first child in September, 1941, she changed her separate account into a joint account of herself and husband for convenience. This account was closed by a withdrawal of $1,669 in October, 1945. (R. 117.)

The corporation reported a loss of $8,937.39 for

the fiscal year ended September 30, 1943, and it lost about $22,000 during the period between October, 1942, and April, 1943, on account of numerous rejections of products and the retooling of equipment for performance of new contracts. But the business again prospered after the partnership took it over and adopted some managerial changes. The partnership's income tax return filed for the period April 1-December 31, 1943, disclosed net profits of $152,760.70, later reduced, however, by $50,000 after the renegotiation of war contracts. The taxpayer and his mother[1] were each credited with 40 percent, or $61,104.28, and the taxpayer's wife with 20 percent, or $30,552.14. Each reported his respective share on an individual income and victory tax return. The taxpayer and his wife withdrew $28,400 and $14,200, respectively, of the shares credited to them, and each deposited the amount withdrawn in their joint bank account. The deposits were used for the payment of living expenses and income taxes and a large balance remained. (R. 117-118.)

For the year 1944 the partnership reported net profits of $114,855.19, of which $45,942.08 was credited to the taxpayer; a like amount to his mother, and $22,971.03 to his wife. Each reported his respective share on an individual income tax return. The taxpayer and his wife made withdrawals of $54,800 and $21,900, respectively, which

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[1] The word "brother" is erroneously used instead of "mother" in the Tax Court's findings of fact. (R. 117.)

they deposited in their joint bank account. During 1944 they used funds from the account to pay living expenses and income taxes, and invested about $20,000 in two single premium policies of insurance on the taxpayer's life, the wife being named beneficiary. They withdrew $10,000 and placed it in a safe deposit box to which each had access. The taxpayer's wife spent $1,800 on a trip for health purposes and $600 for jewelry. A large balance remained on deposit. The taxpayer's wife had a separate savings account, but did not deposit any funds withdrawn from the partnership in it. (R. 118.)

In determining the taxpayer's income and victory tax for 1943 the Commissioner recomputed partnership profits by eliminating $50,000 refunded after renegotiation of the war contracts, and included 60 percent of such profits in the taxpayer's taxable income, reflecting the addition of the 20 percent share, as adjusted, reported by his wife. In determining the taxpayer's income tax for 1944, the Commissioner added to income the $22,971.03 partnership profits reported by the taxpayer's wife. (R. 119.)

On these facts the Tax Court held that no bona fide partnership existed between taxpayer and his wife during the taxable years in question. (R. 119-124.) The Court of Appeals affirmed *per curiam*. (R. 131.)

ARGUMENT

Petitioner's main contention here is that the court below erred in refusing to remand the case to the Tax Court with directions to reconsider it in the light of the decision of this Court in *Commissioner* v. *Culbertson,* 337 U. S. 733. In the latter case such a remand was ordered because the Tax Court had failed to give consideration to all the factors relevant to a determination of the actual intent of the parties. This Court found in that case that the Tax Court had erroneously applied the criteria established in *Commissioner* v. *Tower,* 327 U. S. 280, and *Lusthaus* v. *Commissioner,* 327 U. S. 293. While it is true that the Tax Court in the present case did not have the benefit of the *Culbertson* opinion to guide it in its determination, the record clearly shows that it gave consideration to all of the factors relied upon by taxpayer to establish the existence of a bona fide partnership relation between himself and his wife, and that it reached its conclusion by a proper application of the tests approved in the *Culbertson* case. Since the undisputed facts support the Tax Court's conclusion that the parties did not in good faith and acting with a business purpose intend to form a bona fide business partnership, the Court of Appeals was amply justified in affirming the decision of the Tax Court without remanding it for reconsideration in the light of *Culbertson.* The record shows that the only services contributed by taxpayer's wife to her hus-

band's business were performed during the years 1938-1940 and consisted merely of helping out clerically during the weekends and some evenings; and her only capital expenditures over this period were for personal and family purposes. (R. 113, 117.) And although the taxpayer's wife alleged that she obtained a proprietary interest in the partnership from her mother-in-law in 1939, in consideration of these contributions, it is significant that no recital of such an interest was contained in any articles of partnership prior to the partnership in question which was formed in 1943 on advice of tax counsel. (R. 113-114, 115, 121.) The wife's only contribution to this partnership was a note in the amount of $1,335.45 which was discharged by a check drawn upon a joint account in the names of taxpayer and his wife. (R. 117.) Furthermore, taxpayer's wife never exercised any powers of management and control over the partnership business; rather, the taxpayer retained and exercised all the powers he had enjoyed prior to the partnership's formation. It is true that taxpayer's wife did discuss business matters with taxpayer at home and encourage him in his undertakings (R. 117), but this was not shown to be more than a normal incident of their marital relationship. And with respect to her distributive share of the partnership income, the record discloses that she deposited it in the joint account of her husband and herself and expended it, if at all, for living expenses, income taxes, activities of family concern and the usual

things a husband procures for his wife, although she maintained a separate savings account in which some of her partnership income could have been deposited. (R. 118.)

Although none of these factors, considered alone, might compel the conclusion reached by the Tax Court, it is clear that, taken as an integrated whole, as the Tax Court did (R. 119-124), they justified the determination that this was not a situation where "the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise." *Commissioner* v. *Culbertson,* 337 U. S. 733, 742.

CONCLUSION

The ruling below is correct, and there is no conflict of decisions. The petition for certiorari should be denied.

Respectfully submitted,

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